In the Supreme Court
OF THE
United States

OCTOBER TERM, 1940

No.

MILO W. BEKINS and REED J. BEKINS, as trustees, appointed by the will of Martin Bekins, deceased; MILO W. BEKINS and REED J. BEKINS, as trustees, appointed by the will of Katherine Bekins, deceased; JAMES IRVINE, J. R. MASON, JAMES H. JORDAN, A. HEBER WINDER, as trustee of Eva A. Parrington Trust; C. A. MOSS, and H. E. CURTIS, creditors of Lindsay-Strathmore Irrigation District,

Petitioners,

vs.

LINDSAY-STRATHMORE IRRIGATION DISTRICT, an insolvent taxing agency,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

OPINIONS BELOW.

Opinion of the trial court (R. 131), 25 Fed. Sup. 988.

Opinion of the Circuit Court of Appeals (R. 536, 547), 114 Fed. (2d) 680.

JURISDICTION.

The decision of the Circuit Court of Appeals was rendered September 5, 1940. (R. 595.) A petition for rehearing was filed October 4, 1940 (R. 597) and denied October 15, 1940. (R. 597.) The mandate was stayed until disposition of the case by this Court. (R. 597.) The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code (28 U.S.C. Paragraph 347(a)).

STATEMENT OF THE CASE.

A concise statement of the case is contained in the foregoing petition under the heading of Summary Statement of the Matter Involved, to which reference is made.

SPECIFICATION OF ASSIGNED ERRORS.

Statement of the points relied upon were filed in the Circuit Court of Appeals as required by the rules of that Court. These are set out at pages 488, 510, 527, et seq. of the record and they constitute the errors that were relied upon on the appeal. In the following brief, we, petitioners, set forth the assigned errors under each point which we urge in this Court.

I. THE COURT WAS WITHOUT JURISDICTION TO ENTER THE DECREE.

Chapter IX of the Bankruptcy Act does not apply to the Lindsay-Strathmore Irrigation District.

Assignment of Error No. 6 is as follows:

> "The Interlocutory Decree in this cause interferes with the political and governmental powers of the Lindsay-Strathmore Irrigation District and the property and revenues thereof necessarily essential for governmental purposes." (R. 489.)

Assignment of Error No. 7 is as follows:

> "By the provisions of Section 83 of the Bankruptcy Act the court is without power to apply its order to this irrigation district." (R. 489.)

Assignment of Error No. 14 is as follows:

> "The court erred in making and entering its Findings of Fact and Conclusions of Law herein, and in entering the Interlocutory Decree." (R. 490.)

Assignment of Error No. 1 is as follows:

> "Chapter IX of the Bankruptcy Act of the United States is unconstitutional and void and affects the property interests of the appellants in that it violates Article I, Section 10, Clause 1, of the Constitution of the United States and the Fifth, Tenth, and Fourteenth amendments to the Constitution of the United States." (R. 489.)

A. BY THE TERMS OF THE STATUTE THE COURT WAS WITHOUT JURISDICTION TO MAKE THE ORDER APPEALED FROM.

This is our first point on jurisdiction.

If the statute had been made to apply to public agencies generally, and contained a provision by Congress that the Act should not apply to irrigation districts, there would be no need for argument upon the point that the court would be wholly lacking in jurisdiction to make any judgment or decree which would apply to such an irrigation district. It is well settled that the jurisdiction of the court in bankruptcy matters is limited to that conferred by Act of Congress. (*Wheeling Structural Steel Co. v. Moss,* 62 Fed. 37, 39, and the cases cited therein.)

Under those circumstances, the irrigation district simply would not be authorized to avail itself of the Act. Or, put another way, the court would have no jurisdiction to make any order approving any composition by an irrigation district with its creditors. Yet, as to the political or governmental powers of the petitioner, the statute in effect stands exactly in that condition.

Section 83 (c) of the Bankruptcy Act, which is Section 403, Title 11, U. S. C., after stating that the Court may enjoin proceedings and put the plan temporarily into effect, provides:

> "* * * **But shall not, by any order or decree, in the proceedings or otherwise, interfere with (a) any of the political or governmental powers of the petitioner** * * *." (Emphasis ours.)

This provision is in the statute itself.

The Court below in the case of *West Coast Life Ins. Co. v. Merced Irrigation District,* 114 Fed. (2d) 654, 662:

> "The Court in the Bekins case did not premise its decision on the fact that the District involved was not a state agency, but rather that the Act as drawn did not usurp state powers. Let us quote again from the Bekins decision (p. 51) wherein the Court quotes the Committee on the Judiciary:
>
> " ' "The bill here recommended for passage **expressly avoids any restriction on the powers of the States or their arms of government in the exercise of their sovereign rights and duties. No interference with the fiscal or governmental affairs of a political subdivision is permitted.** The taxing agency itself is the only instrumentality which can seek the benefits of the proposed legislation. * * *" ' "
>
> "The Court then states:
>
> " 'We are of the opinion that the Committee's points are well taken and that Chapter X (§§ 81-84) is a valid enactment. **The statute is carefully drawn so as not to impinge upon the sovereignty of the State.** * * *' " (Emphasis ours.)

From the above quotation the Court below recognized that the Court in the *Bekins* case (Petitioners throughout will refer to the decision of the U. S. Supreme Court when the instant case was before that Court as the "Bekins case") did not premise its decision on the nature of the district, "but rather that the Act **as drawn** did not usurp state powers".

The above quoted provision from the statute is the one that expressly withholds jurisdiction to "usurp state powers".

This Court in the *Bekins* case quotes the Committee on the Judiciary as stating that

> "* * * The bill here recommended for passage **expressly avoids any restriction on the powers of the States or their arms of government in the exercise of their sovereign rights and duties. No interference with the fiscal or governmental affairs of a political subdivision is permitted** * * * no control or jurisdiction over that property and those revenues of the petitioning agency necessary for essential governmental purposes is conferred by the bill." (Emphasis ours.)

Then this Court concludes that the Committee's points are well taken, and states:

> **"The statute is carefully drawn so as not to impinge upon the sovereignty of the State."** (Emphasis ours.)

Again, the provision above quoted from the statute is the one clearly that "**expressly** avoids any restriction on the powers of the states or their arms of government". (Emphasis ours.)

The above quoted provision from the statute is clearly the one that provides:

> "No interference with the fiscal or governmental affairs of a political or governmental subdivision is permitted."

The above quoted provision of the statute is clearly also the one which makes the statute one "carefully

drawn so as not to impinge upon the sovereignty of the State".

This Court in the *Bekins* case held the statute constitutional because it "expressly avoids any restriction on the powers of the States or their arms of government in the exercise of their sovereign rights and duties".

Since Congress, by the portion of the statute above quoted, has by mandatory language provided that the court "shall not, by any order or decree, in the proceedings or otherwise, interfere with any of the political or governmental powers of the petitioner", the question is narrowed down to this: Are the powers of petitioner that are being interfered with by the order or decree appealed from "political or governmental"? If they are, then by the terms of the statute the court had no jurisdiction. It is only by determining that they are not political or governmental that the court can logically be held to have jurisdiction.

The suggestion on page 663 of the opinion of the Court below that that portion of the Supreme Court's opinion (p. 54) that Congress may, with the consent of the state, exercise the bankruptcy power over state agencies, and the further suggestion that the Supreme Court may have found procedural differences in the two acts to justify the conclusion that the later act did not impinge the sovereign rights of the state, in no way weakens our argument. No act of the state, affirmative or negative, and no consent of the state, and no procedural differences, can in any wise change the declaration of Congress in the later act now in

force that the court "shall not * * * interfere with any of the political or governmental powers of the petitioner". The consent of the state that its agencies may avail themselves of the provisions of the act is necessarily subject to this provision of the statute just quoted.

It will be recalled that the *Bekins* case was before the Court under the Act of August 24, 1937 (c. 754, 50 Stat. 751), which permitted a direct appeal from the District Court where the constitutionality of the federal statute is drawn into question.

At page 2 of the Brief of the United States in the *Bekins* case, it is stated:

> "QUESTION PRESENTED.
>
> "Whether the Act of August 16, 1937, is a valid exercise by Congress of its power 'to establish * * * uniform laws on the subject of bankruptcies throughout the United States.' "

The Court had before it simply the constitutionality of the Act, and the Court in reading the Act found that Congress had expressly denied jurisdiction to the court to make any order that would interfere with the political or governmental powers of the petitioner, and further than this the court was not required to go.

While the Court in the *Bekins* case did not find it necessary to pass upon the nature of the petitioner then before it, for reasons hereinabove suggested, it was argued at considerable length by the Solicitor General in his brief commencing at page 82 that the

irrigation district then before the Court was not strictly an agency exercising governmental or political powers. After pointing out that the district in the *Ashton* case was held to be a political subdivision, he states (p. 82):

> "* * * But in the case at bar the Lindsay-Strathmore Irrigation District is not a 'political subdivision' of the State of California, and Chapter X is carefully constructed to permit a separable operation."

He further states (p. 84):

> "* * * Thus, while the irrigation district exercises a narrowly restricted group of governmental powers, the California courts have repeatedly announced that it 'is not a political subdivision of the state or county, or a political subsidiary at all' * * *"

He further states (p. 85):

> "If the State of California, for its domestic purposes, itself refuses to give to the District all of the investiture of the sovereignty of the State, we submit that this Court should not invalidate an Act of Congress because of a supposed interference with the sovereignty of California * * *."

The Solicitor General then concludes his statement on that point (p. 86) in the following words:

> "It is, therefore, perfectly plain that Congress intended Chapter X to stand **so far as it covered any taxing agency to which it could constitutionally be applied.** It follows, since the Lindsay-Strathmore Irrigation District is not a political subdivision of the State, that the judgment must

> be reversed **whatever the validity of the Act as applied to taxing agencies which under local law share enough of the powers and immunities of the sovereign to be termed political subdivisions.**" (Emphasis supplied.)

In the *Bekins* case the irrigation district, appellant, at page 19 of their brief, makes similar argument as to its own nature. Among other things it says:

> "Any contention that it (an irrigation district of California) is inextricably connected with the sovereignty of the State of California finds no support in the decisions of the highest court of that state which would not result from the admitted impossibility (or undesirability) of formulating a rule by which the 'political', 'public' or 'governmental' activities or functions of an agency are to be distinguished from its 'private', 'corporate' or 'proprietary' activities or functions, in tort cases, eminent domain cases, execution upon property cases, and tax cases."

In passing, it should be noted that this Court in the *Bekins* case followed these arguments and in fact refers to California irrigation districts as merely "improvement districts" when it said "improvement districts, such as the petitioner, were in distress". (304 U.S. 53.)

We mention these arguments of counsel in the *Bekins* case to show that this Court had before it in the *Bekins* case only the broad constitutional question, and that counsel for appellants (both for the district and for the United States) recognized that the statute would be held to be unconstitutional unless

the governmental or political functions of the district could be taken out from under the control of the court under the statute, and thus the extended argument that California irrigation districts were not either political or governmental, or that, if political or governmental, yet to some extent they exercised proprietary or private functions so that the statute could be given some application to them, and would come within the saving clause in Section 401, Title 11, U. S. C.

The Supreme Court held the Act constitutional because the Act by its terms (as shown by the extract therefrom above quoted) especially and specifically and by mandatory language withholds jurisdiction from the Court to "interfere with any of the political or governmental powers of the petitioner".

Now at the time the *Bekins* case was decided there was no decision from any of the courts of California holding directly that **all** of the functions of an irrigation district were exclusively governmental, regardless of what may have been suggested or hinted at. Since the decision in the *Bekins* case, however, we have the several cases, commencing with *El Camino Irrigation District v. El Camino Land Corporation,* 12 Cal. (2d) 378, 383 (85 Pac. (2d) 123), where the Court said a California irrigation district is a district

> "* * * whose functions are considered exclusively governmental; their property is state owned, held only for governmental purposes; they own no land in the proprietary sense, within the rule of defendant's cases * * *."

See also:

Moody v. Provident Irrigation District, 12 Cal. (2d) 389, 395 (85 Pac. (2d) 128);

Anderson-Cottonwood Irrigation District v. Klukkert, 13 Cal. (2d) 191, 197 (88 Pac. (2d) 685);

Peoples State Bank v. Imperial Irrigation District, 99 C. D. 317, 101 Pac. (2d) 466. (In this case the Court indicated that it had not intended to announce any new principle of law as to the status of a California irrigation district, but the fact remains that the California courts had not only failed, up to the time of the Bekins decision, to hold that the functions of a California irrigation district are exclusively governmental, but in some instances went pretty far in the opposite direction.)

It is respectfully submitted that, though the Act may be held to be entirely constitutional, this Court should not ignore the express mandate of the statute that the district court cannot "by any decree or order interfere with any of the political or governmental powers of petitioner", and it should not ignore the recent decisions of the highest court of California to the effect that all of the functions of petitioner are exclusively governmental. This is a matter of local law as to which the decisions of the highest court of the state are authoritative and conclusive in the federal courts.

Bank of Augusta v. Earle, 13 Peters 519, 10 L. ed. 274, 310;

Norton v. Shelby County, 118 U. S. 425, 30 L. ed. 178, 185;

Baltimore & Ohio R. R. Co. v. Baugh, 149 U. S. 368, 371-372, 37 L. ed. 772, 775;

Claibourne County v. Brooks, 111 U. S. 400, 28 L. ed. 470, 474;

W. T. Waggoner Estate v. Wichita County, 273 U. S. 113, 117, 71 L. ed. 566, 568;

Sutter Butte Canal Co. v. Railroad Commission, 279 U. S. 125, 139, 73 L. ed. 637, 641;

Memphis & C. R. Co. v. Pace, 282 U. S. 241, 244, 75 L. ed. 315, 319;

Bandini Petroleum Company v. Superior Court, 284 U. S. 8, 18.

Had the decree been permissive merely the objection would be equally good but the decree in this case actually commanded the district to deposit certain funds. The Court below surely erred in declaring in its opinion (114 Fed. (2d) 685) that this is not a matter of which the bondholders can complain.

For the very purpose of these proceedings by the petitioner for composition of its indebtedness under the statute is to interfere in the fiscal and other affairs of the district, and it cannot be successfully denied but that such is the effect of the order appealed from. Since all of the functions of petitioner are exclusively governmental, the conclusion is inescapable that the order appealed from interferes with the governmental powers of the petitioner. Yet the statute declares that the Court "shall not, by any order or decree, interfere with any of the political or governmental powers of the petitioner".

We respectfully submit that it logically follows that, by the terms of the statute, the Court was without jurisdiction to make the order appealed from.

We have dealt with this point at considerable length, as it is one that goes to the very foundation of the case. Since Congress has not given the court the power to deal with these functions, and has expressly prohibited it from so doing, it requires no argument to show that the Court is wholly lacking in jurisdiction.

In closing on this point may we suggest that to uphold jurisdiction is to determine that "ability to pay" must necessarily become the gauge of the power of taxation.

B. IN VIEW OF THE CALIFORNIA DECISIONS RENDERED SINCE THE BEKINS CASE, HOLDING THAT ALL OF THE FUNCTIONS OF AN IRRIGATION DISTRICT IN CALIFORNIA ARE EXCLUSIVELY GOVERNMENTAL, WHETHER THE STATUTE AS APPLIED TO SUCH A DISTRICT IS CONSTITUTIONAL IS STILL AN OPEN QUESTION. THE STATUTE AS SO APPLIED IS UNCONSTITUTIONAL.

Our second point as to lack of jurisdiction goes to the constitutionality of the Act as applied to one of these districts and is based upon the proposition that since all of the functions of an irrigation district in California are governmental and that point has been definitely settled and made clear beyond dispute since the decision in the *Bekins* case, the constitutional question as applied to such a district is still an open one.

Since it appears by both the Bekins and the Ashton decisions that the strictly governmental functions of

the petitioner are beyond the control of Congress, under the Bankruptcy power, the Act is actually unconstitutional as applied to one of these districts. The Act simply does not apply, and cannot be made to apply, to a California Irrigation district.

In the *Bekins* case the Court did not pass upon the nature of the petitioner. It was perhaps not even necessary. It was strongly argued, as we have also seen, that the petitioner was either not governmental at all or was only partly governmental. If at that time it had been settled by California decisions that all functions of such a district are governmental there can be little doubt but that this Court would have accepted that determination and held the Act void as to such districts. But it was not settled at that time. Since then, however, it has become thoroughly settled that irrigation districts "* * * are agencies of the state whose functions are considered exclusively governmental; their property is state owned, held only for governmental purposes; they own no land in the proprietary sense, within the rule of defendant's cases * * *." (*El Camino Irrigation District v. El Camino Land Corporation, supra.*)

The rule is well settled that in dealing with local law the United States Courts will follow the decisions of the highest Court of the state, and will change their position if necessary.

See:

Elmendorf v. Taylor, 10 Wheat. 152, 6 L. ed. 289;

Chicago M. St. P. & P. R. Co. v. Risty, 276 U. S. 567, 72 L. ed. 703;

Green v. Lessees of Neal, 6 Pet. 291, 8 L. ed. 403, 405;

Fairfield v. Gallatin Co., 100 U. S. 47, 25 L. ed. 544, 546;

Wade v. Travis Co., 174 U. S. 499, 43 L. ed. 1060, 1064.

The Circuit Court of Appeals for the Eighth District in *Luehrmann v. Drainage District No. 7,* 104 Fed. (2d) 696, 698, after pointing out that the district involved in the *Ashton* case was held to be a political subdivision of the state, and that Drainage District No. 7 "is not a governmental agency", upheld the constitutionality of the new Municipal Bankruptcy Statute (Act of August 16, 1937, 50 Stat. 654, 11 U. S. C. §§401-404), and said:

> "This ruling is based upon the decisions of the Supreme Court of Arkansas holding that drainage districts are quasi-public corporations which are not political or civil divisions of the state like counties and municipal corporations created to aid in the general administration of the government. They are not created for political purposes, nor for the administration of the government. Appellants do not contend that the petitioner falls within the limitation upon the power springing from this amendment to the Bankruptcy Act, which limitation was declared in the Ashton case."

Since under the recent decisions of the Supreme Court of California (decided since the *Bekins* case) it is now settled that a California irrigation district is a state agency whose functions are exclusively govern-

mental, we respectfully submit that the statute, if applied to a California irrigation district, is unconstitutional, both under the *Ashton* case and under the *Bekins* case.

II. THE CAUSE IS RES JUDICATA.

Assignment of Error No. 4 is as follows:

"The cause is res judicata." (R. 489.)

Assignment of Error No. 48 is as follows:

> "The court erred in failing to find that the particular issue as to the validity of the powers referred to in said subdivision (e) and the right of the trial court to exercise said powers were involved and were necessarily involved in the trial of said prior proceeding, and said issue was determined in favor of the dissenting bondholders in this case." (R. 497.)

In 1935 the Lindsay-Strathmore Irrigation District filed a petition under the first Municipal Bankruptcy Act. This petition involves the same plan of composition as the instant proceedings. (R. 363.) The petitioners also appeared by answer and objections. The Court heard the case on the merits and made findings of fact and conclusions of law (R. 423) and entered a decree confirming the plan of composition. (R. 452.) These petitioners appealed to the Circuit Court of Appeals, which court reversed. (R. 468-9.) (*Bekins v. Lindsay-Strathmore Irr. Dist.*, 88 Fed. (2d) 1004.) The assignment of errors specified that the plan was unfair, inequitable, unlawful, the statute

unconstitutional and other grounds. The lower Court following the issuance of the mandate entered judgment, dated July 26, 1937, in favor of these petitioners which judgment became final. (R. 470.) Neither the Circuit Court of Appeals opinion nor the mandate (R. 469) specified the exact grounds of reversal.

It is therefore contended that this cause is *res judicata* on all points between these parties. The first Municipal Bankruptcy Act has not been repealed. Sections 78 through 84 constitute the present Municipal Bankruptcy Act. The second statute is merely an amendment of the first. It is all one law on the subject of municipal bankruptcy. Congress could have provided that a decree entered under Section 80 would not be a bar to a proceeding under Section 81, but did not do that. It merely provided that "the initiation of proceedings * * * under Section 80 shall not constitute a bar" to a proceeding under Section 81 (Section 83(h)).

So far as the form of the decree is concerned, either decree could equally have been entered under either one of these two enactments, Section 80 or Section 81. Both decrees are equally embraced within the power purportedly granted by Congress under each of these acts. Comparing the language of the two decrees (R. 452, 187) it will be seen that they are in substantial identity. In other words, the district here seeks to obtain, in effect, the same decree which it first obtained under the former proceeding. In logical effect it was adjudged in the first case that the decree in the second case could not be entered.

Where a rule of law becomes *res judicata,* the question in the second case only arises because the judgment would be different but for the former adjudication.

In the opinion in the case of *West Coast Life Insurance Co. v. Merced Irrigation District,* 114 Fed. (2d) 654, 661, the Court seems to hold that it does not appear from the Merced record, the grounds upon which the decree was reversed, saying:

> "There is nothing to indicate whether we relied upon the argument made at the hearing that the legislation was beyond the power of Congress, or upon the argument that consent of the State would constitute an impairment of the obligation of contract. In fact, it does not even appear that we based our decision on either of these arguments."

The Court goes on to say:

> "It cannot be said that the decision is res judicata as to either rule of law relied upon by appellants."

and seems to us to state that where a number of grounds are urged the decision "cannot be *res judicata* of all possible grounds for such order". There is no separate discussion of this matter in the opinion in the *Lindsay-Strathmore* case, and we look to the *Merced* case for the reasons for the confirmation of the Lindsay-Strathmore decree.

In the case of *Chicot County Drainage District v. Baxter State Bank,* 60 S. Ct. 317, 308 U. S. 371, this Court said:

> "The remaining question is simply whether respondents having failed to raise the question in the proceeding to which they were parties and in which they could have raised it and had it finally determined, were privileged to remain quiet and raise it in a subsequent suit. Such a view is contrary to the well-settled principle that res judicata may be pleaded as a bar, not only as respects matters actually presented to sustain or defeat the right asserted in the earlier proceeding, 'but also as respects any other available matter which might have been presented to that end'. Grubb v. Public Utilities Commission, supra; Cromwell v. County of Sac., supra."

The former judgment, therefore is *res judicata,* not only that Congress does not have the power requisite to these proceedings, but that the plan is inequitable, unjust and unfair.

III. THE PLAN LACKS CONSENT.

Assignment of Error No. 17 is as follows:

> "The court erred in finding and holding that the Reconstruction Finance Corporation is a creditor affected by the plan." (R. 490.)

Assignment of Error No. 41 is as follows:

> "The court erred in not granting the motion of respondents to classify the Reconstruction Finance Corporation's claims separately and as claims not affected by the plan." (R. 495.)

Neither the R.F.C. nor Burns as trustee are creditors affected by the plan.

Section 81 of the Bankruptcy Act requires that not less than 51% of the securities **affected by the plan** (excluding any owned, held or controlled by the district) have accepted it in writing.

Petitioners made a motion in the trial Court to classify the creditors. (R. 109.) The Court gave notice (R. 110) to these parties.

The classification by the Court we contend was erroneous. Subdivision (a) of Section 83 provides:

> "No creditor shall be deemed to be affected by any plan of composition unless the same shall affect his interest materially, . . ., * * *".

In Section 82 it is provided that the term "security affected by the plan" means security as to which the rights of the holder are to be modified materially by the composition. This, of course, means adversely affected. We have already explained the mechanics of this transaction in the statement made in our accompanying petition. Even though Section 82 enacts that "Any agency of the United States holding securities acquired pursuant to contract with any petitioner under this chapter shall be deemed a creditor in the amount of the full face value thereof". We point out that these bonds were not acquired by the R.F.C. "under this Chapter", since the bonds, if acquired at all by the R.F.C., were acquired under the former Chapter IX. Nor are they "acquired", since they are merely held as collateral. Furthermore, the main block of the bonds are owned and held by W. J. Burns (R. 117) and they are not owned or held by the R.F.C. except as collateral and in consequence this

clause in Section 82 does not give any validity to the consent of the R.F.C. In fact this enactment in no way applies to such a situation as in this case. Finally we point out that so far as subdivision (j) of Sec. 83, is concerned, providing that consent to plans partially completed may be given by the holders of exchanged securities, it was enacted after the petition in this case was filed. The date of that enactment is June 28, 1938, and the date of the filing of this petition is September 21, 1937. It does not appear to be intended to vitalize a proceeding that was otherwise lifeless.

Ginsberg v. Lindel, 107 Fed. (2d) 721, 726.

Title 43, Section 403, U.S.C., under which the loan in this case was given by the R.F.C. provides that no loan shall be made until an agreement has been made between the district and its bondholders "under which a substantial reduction will be brought about in the amount of the outstanding indebtedness of the applicant". Therefore the R.F.C. had no authority to make a disbursal unless the reduction of indebtedness was immediately as opposed to ultimately effected.

As a matter of fact the R.F.C. agreement (R. 202) did not require that all of the debt should be liquidated, but only "the greater part". The clause in the R.F.C. resolution (R. 207) regarding the maintenance of "parity" of rights, which provides that the division chief of the R.F.C. may elect to keep the deposited securities alive to maintain a parity of rights shows upon examination that the intention was to maintain a parity of rights between the holders of the deposited securities and of the securities which were not deposited and in case it is necessary to keep them

alive then owners' agents are to be appointed. But no owners' agents were appointed. An entirely different procedure was set up by which the bonds were transferred to a man by the name of Burns, eliminating all rights of the former depositors.

Subdivision (b) of Section 5 of the R.F.C. resolution (R. 207) goes on to provide that in case the district pays interest on the note the corporation will accept such interest payments and give credit to the district for payment of interest of the deposited sesecurities. (Interest at 4% has been paid the R.F.C. since the disbursal of the loan on the amount disbursed (R. 573-574).) Therefore in this case there is no question but that the payment of 4% to the R.F.C. was a preference. And also there is no question but that this payment of 4% interest resulted in discrimination since we did not get any interest. Our interest coupons are still unpaid. Burns' coupons are liquidated.

Burns' deposition shows him to be a mere willing tool of the district, created to give color to its contention made in bad faith that the bonds are still alive. He testified that he was a "trustee of the Lindsay-Strathmore Irrigation District". (R. 393.) "The trust agreement represented his entire authority as trustee . . .". (R. 404.) "Mr. McBride[1] handled all the transactions for him". (R. 403.) Upon cross-examination by Mr. McBride Burns said he made a mistake if he said he was trustee for the district. For whom was Burns trustee? Trustee for Bad Faith. He did not dare comply with Section 83(a) requiring

1. The District 's counsel.

a statement by the trustee of his beneficiaries and his authority and his compensation. Petitioners' motion to strike the consents and the claims of Burns and the R.F.C. on this ground and the ground that neither are creditors adversely affected by the plan was denied. (R. 351.) This was error.

IV. THE PLAN WAS FULLY EXECUTED OUT OF COURT.

Assignment of Error No. 22 is as follows:

> "The court erred in finding that said plan was not prepared or substantially completed or executed several years before the commencement of this proceeding, and in finding that said plan is a plan of composition pursuant to said Chapter IX." (R. 491.)

Assignment of Error No. 30 is as follows:

> "The court erred in holding that sub-paragraph (j) of Section 83 of the Bankruptcy Act of the United States in any way applies to the consent of the Reconstruction Finance Corporation or to these proceedings." (R. 493.)

The R. F. C. has no authority to extend the time of the loan beyond a year. Title 15, Section 604(a) U.S.C. provides:

> "No funds shall be disbursed on any commitment or agreement to make a loan or advance hereafter made by the Reconstruction Finance Corporation after the expiration of one year from the date of such commitment or agreement; * * *."

This is further shown by the District's Exhibit 7 (R. 241), which is a resolution of the R.F.C. reciting the two previous loans have expired and granting a new loan and incidentally requiring that $100,000.00 be escrowed and held for the benefit of the R.F.C. (R. 241.) The apparent purpose of this requirement of the deposit of $100,000.00 was (it should be noted it is not in any way authorized by the vote of the people at the election for approval of the plan (R. 361)) a guarantee against the claims of the non-depositing bondholders.

The conduct of the parties shows that the transaction was complete and ended. The old loans expired. The R.F.C. demanded a cash deposit of $100,000.00. The district paid interest on the R.F.C. loan. (R. 573-4.) The R.F.C. reports to Congress that it made a loan to the district (not Burns). (R. 478.)

The petition in the former bankruptcy case (R. 411) recited (R. 415) that creditors of petitioner "owning not less than 30 per centum in amount of bonds, * * * have accepted said plan in writing, by the deposit of said bonds in escrow as hereinafter set forth,".

The findings in that case (R. 423, 443) determined that creditors holding more than two-thirds, namely, 85%, had accepted the plan in writing and that the writing had been filed in that proceeding. The findings and decree there indicated that the bondholders deposited their bonds and accepted the plan. Those bonds were made subject to the plan. The plan was fully executed as to those bonds which were sur-

rendered. On the other hand the decree was reversed as to the petitioners. They only are not bound by the plan. The plan has been fully executed and adjudicated as between the original bondholders and the district. *Chicot County Drainage District v. Baxter State Bank,* 308 U. S. 371.

V. THE PLAN OF COMPOSITION IS UNJUST, UNFAIR, INEQUITABLE AND DISCRIMINATORY.

Assignment of Error No. 8 is as follows:

> "The plan of composition herein is unfair, inequitable, and unjust and is not for the best interests of the creditors and it discriminates unfairly in favor of the Reconstruction Finance Corporation." (R. 489.)

Assignment of Error No. 66 is as follows:

> "The court erred in finding that the taking of title by the district to one-third of its lands had any substantial effect on the ability of the district to carry its bonded indebtedness since there is not and never has been any water available for the irrigation of the lands to which title was taken, and they never supported any substantial part of the bonded debt." (R. 501.)

PAYMENT OF INTEREST.

The district put in escrow $62,000.00 to pay interest at 4% from November 1, 1934 upon the refunding value of the bonds deposited. (R. 243.) This interest was paid up to the date of disbursal by the R.F.C. on April 26, 1937. Subsequently interest at 4% has been paid to the R.F.C. on the amounts borrowed. The plan of composition itself does not provide for interest

to depositing bondholders. The district stipulated "It was actually a contribution by the irrigation district to the depositing bondholders. The offer of interest originated from the district in order to induce deposit of the bonds * * *". (R. 261.) The Court below does not touch upon this question in the instant case but refers to it in the *Merced* case where the Court's position seems to be that because the interest paid to the depositing bondholders was not a part of the plan it is an outside matter and does not concern the Court. We contend that it is discriminatory and coercive. The fact it was outside the plan would appear to be sufficient lack of good faith to invalidate the plan under the decision in the *City of Avon Park* case (supra). Furthermore we point out that the 4% interest paid to the R.F.C. is available under the plan itself and that the money is provided by the plan and if denied to the petitioners it is only denied as a matter of coercion and there is no reason why the alleged bankrupt should benefit at the expense of the petitioners. These interest items amount to roughly $150.00 per bond. (4% on $600 from Nov. 1, 1934.)

Would it have been proper to pay a greater lump sum of money as a consideration to acceptors of the plan? Would not such a payment have been an unlawful preference? And how indeed can the district pay anything outside the plan? We have shown that the R.F.C. agreed that the 4% interest received would be accepted in lieu of the payment of the interest coupons on the deposited securities. (R. 208.) Therefore the payment of this interest to the R.F.C. and the denial of it to the petitioners is essentially discrim-

inatory and amounts to saying that the creditors who accept the plan will be paid this interest, but those who do not accept it will be denied interest. When it is considered that the petitioners successfully contested the first bankruptcy proceeding, the injustice of depriving them of interest during the period of this litigation is all the more apparent.

THE PRINCIPLE OF THE BOYD CASE.

The principle of the *Boyd* case *(Northern Pacific Ry. Co. v. Boyd,* 228 U. S. 482), if applied to this case would seem to require reversal. It is no answer to say that debtor is a public corporation and that its assets cannot be taken over by the Court. In *Newhouse v. Corcoran Irrigation District,* 114 Fed. (2d) 690, the Court below in a case decided the same day as the instant case said:

> "The bankruptcy of a public entity, however, is very different from that of a private person or concern."

saying further:

> "such assets and such property within the District cannot be disposed of as in the ordinary bankruptcy proceeding for the benefit of a debtor."

Yet in the case of *Fano v. Newport Heights Irrigation District,* 114 Fed. (2d) 563, also decided the same day the same Court said:

> "It is undoubtedly true that the District has not funds in hand to fully pay this due interest and in that sense is insolvent, but it is not only far from insolvent in the bankruptcy sense, but owns

> debt free, except for the interest mentioned, assets in value many times the indebtedness, all in most excellent physical and almost new condition."

Thus it appears that the Court below deemed that the words "fair and equitable" signify something which is fair and equitable in the **mind of the judge** but do not connote any definite standard or yardstick to be applied in these cases, and this solely because a public corporation is involved and its assets are not subject to seizure for the debts of the creditor.

It is the position of the petitioners that the same principles which apply to a private corporation in determining the question of fairness and equity apply with like force in the case of a public corporation.

As bearing, therefore, upon the question that the plan of composition here is not fair or equitable, we respectfully suggest the following considerations:

1. The assets of the bankrupt exceed its debts many times over. The total assessed value of the district (R. 343) is $1,648,700.34. This is for raw land without improvements. In addition the financial statement of October 31, 1935 shows capital assets in excess of the debts amounting to $731,544.60. The same condition is true as of October 30, 1938 (R. 347), except that by 1938 the capital assets have increased. See, also, R. 441, where the same Court in the first case made a special finding as to assets, which did not include land or private improvements, finding them to equal over two million dollars. The bond debt is $1,427,000.00 principal which with interest ag-

gregates $1,981,920.57. The district in its application for a loan to the R.F.C. represented that the assessed value of the land was $80.00. The percentage used by the assessor is 40%, which would mean an average of $200.00 per acre. This application by the district (R. 407) also states that the fair value of citrus lands is between $750.00 and $1000.00 per acre. This means that 8000 acres of the 14,000 are worth $6,000,000.00. The district itself estimated the value at $10,000,000.00. (R. 408.)

2. The District Securities Commission having jurisdiction over the affairs of the district made a finding (R. 231) (as is required by law) that the new refunding bonds do not exceed 60% of the aggregate value of the water, water rights, and other properties owned by the district and the reasonable value of the lands. In other words the plan of composition offers not to exceed 60% of the value of a portion of the bankrupt's assets.

3. This district has a bonded debt of $1,427,000.00, yet in the past ten years it expended one million dollars in litigation. (R. 382, 379.) The fact that this district was able to make such tremendous expenditures over and above meeting its bond obligations in full up to 1933 is impressive of the ability of the district to pay.

4. The fact that the bond issues were scheduled to mature over a short period of twenty years when the California law permits a period of fifty years was one of the vital factors affecting the default of the district. Under ordinary circumstances such a

bond issue would be refunded and the maturities extended over a further period of probably forty years without capital loss to the creditors. Why not such a plan now?

5. During the period that this district has been in default it has purchased capital assets in the amount of $300,000.00 (R. 382), and in addition has deposited a cash reserve of $100,000.00 (R. 383) with the R.F.C. and has substantial cash on hand, $121,-332.32. (R. 347.) If these amounts alone were applied to the indebtedness in addition to the composition offer, it would amount to an offer of 100 cents on the dollar of principal (excluding interest) instead of 60 cents.

6. The cost of production per acre is $154.89. (R. 308.) This includes $7.00 an acre for district taxes. (R. 322.) If the condition of the district is as bad as represented, $7.00 out of $154.00 cannot save the district, and it is unfair to take over 50% of the investment of the petitioners if it will only reduce a part of $7.00 expenses out of every $154.00. (This $154.00 includes $30.00 per acre for water toll. The district may lawfully levy water tolls or taxes. Therefore the water cost is really $37.00 per acre and of this only a part of $7.00 will be affected by the plan.)

7. The plan gives bonds to the R.F.C., but requires the petitioners to take cash.

8. Payment of 4% interest to the consenting creditors and denial of it to the objecting creditors was discrimination.

9. Petitioners have vested rights, *Provident Land Corporation v. Zumwalt,* 12 Cal. (2d) 365, 85 Pac. (2d) 116. These vested rights consist of (a) the money in the bond fund, (b) $100,000.00 deposited with the R.F.C., (c) $300,000.00 water stock, (d) tax sale certificates, (e) tax deeded lands, 5000 acres.

10. The Court below in its opinion in the *Fano* case, supra, in spite of the fact that the tax delinquency reached 30.3%, pointed out that over a period of years the delinquency, when credit is given for the collections actually made, amounted to less than 5% and the same line of reasoning in the instant case leads to the same conclusion. In the *Fano* case seven years of aggregate tax delinquencies amounted to 141.1%, whereas in the instant case (R. 331) tax delinquencies for the same period is the aggregate of 90.6% or some 50% less than in the *Fano* case. The average delinquency in the *Lindsay-Strathmore* case is less than 13%, whereas the statute anticipates a delinquency of 15%. In effect, the district collected $102.00 for every $100.00 in its budget during this period. Of course it did not levy sufficient to pay its debt in full, but it could have levied more and during the last three years the tax delinquency is less than 3%. In fact, an examination of the disbursements and receipts for the years 1921 to 1938 shows the total income for these years is $5,889,328.94, and expenditures $5,768,796.62. (R. 330.) The exhibits at R. 329 and 330 show that the difference between the income of the district for the period 1921 to 1938 is two and a half million dollars over

and above its **necessary operating expenses,** not taking into account one million dollars for litigation costs for that period. It is respectfully submitted that where the assets of a bankrupt exceed its liabilities, that the principal of an obligation should never be cut, but the payment of the debt should be amortized in the future so as to come within the income.

11. The District Court in its "Conclusions of the Court" (R. 131, 139), which were made part of the findings (R. 158), said:

> "the strongest evidence of the fairness and equity of the settlement is the indisputable fact that creditors representing more than 87 per cent. of the total amount of the outstanding indebtedness have voluntarily agreed to it * * *."

12. Both lower Courts commit error in stating that one-third of the land has gone to the district for tax delinquency. By 1933 the district had taken title to 4524 acres. (R. 331.) The district secretary said "The district does not have water for that land". (R. 386.) The basis of the Court's conclusions of fairness fall.

VI. THE PLAN OF COMPOSITION IS NOT PRESENTED OR ACCEPTED IN GOOD FAITH.

Assignment of Error No. 11 is as follows:

> "The offer of the plan and its acceptance are not in good faith." (R. 490.)

A want of good faith is shown in these proceedings by the following facts:

1. The failure of the district since 1933 to levy assessments under the provisions of Section 39 of the California Irrigation District Act.

2. Payment of interest to the depositing bondholders and to the R.F.C. and withholding similar advances from the non-depositing bondholders.

3. Assisting a creditor to "buy its way into Court", in that the district aided the R.F.C. at every turn to acquire its bonds which is denounced in *In re Hudson Coal Co.*, 22 Fed. Supp. 768 at 770.

4. By contributing to the cost of the so-called "purchase" of the depositing bonds $62,000.00 paid the bondholders. (R. 243.)

5. Because the district has relief under Section 11 of the California Statutes, and the Districts Securities Commission Act. (Appendix p. i.)

6. Burns and the R.F.C. declined to comply with Section 83(a) requiring the filing of a statement as to beneficiaries and compensation and he does not disclose for whom he is trustee.

7. The bonds come within that category of control which clearly indicates that the ownership of the bonds in any event is not in the hands of an investor who is adversely affected. The petitioners are all bondholders who have held their bonds for many years. They are not speculators. The holders of the consenting bonds paid sixty cents per dollar of their bonds and their consent is simply the product of the district's influence and reflect more the district's desire rather than an expression of an investor's inde-

pendent business judgment. *American United Mutual Life Insurance Co. v. City of Avon Park,* 61 S. Ct. 157, November 25, 1940.

VII. THE CREDITORS WERE NOT PROPERLY CLASSIFIED.

Assignment of Error No. 16 is as follows:

> "The Court erred in classifying the creditors, including the Reconstruction Finance Corporation, as one class". (R. 490.)

Assignment of Error No. 33 is as follows:

> "The Court erred in finding and holding that equity requires that any composition under the Bankruptcy Act, that all the bondholders should be considered as of equality and dealt with on a parity." (R. 494.)

We now come to one of the most important factual and legal questions involved in this case and one upon which neither of the Courts below made any comment in their respective opinions. From the opinions issued by the same Courts, however, in other cases it appears that the theory of the trial Court and the Circuit Court of Appeals is that the preference claimed by the petitioners is not a "preference as allowed by law" and that in any event that when bankruptcy intervenes these preferences cease to have place.

Section 83(b) provides that "the judge shall classify the creditors according to the nature of their respective claims and interests: Provided, however,

That the holders of all claims, regardless of the manner in which they are evidenced, which are payable without preference out of funds derived from the same source or sources shall be of one class. The holders of claims for the payment of which specific property or revenues are pledged, or which are other wise given preference as provided by law, shall accordingly constitute a separate class or classes of creditors."

Subsection (e) provides that at the conclusion of the hearing the judge shall enter an interlocutory decree if satisfied that the plan

> "(1) * * * does not discriminate unfairly in favor of any creditor or class of creditors;"

Petitioners claim that under Section 52 of the California Irrigation District Act and the California decisions construing it, they have a preferential right to have their matured bonds and coupons which were the only matured bonds and coupons presented for payment paid in the order in which they were presented for payment, and consequently that petitioners are "holders of claims for the payment of which specific property or revenue are pledged", or that if this be not true, in any event they are the holders of claims "which are otherwise given preference as provided by law" within the meaning of Section 83(b) of the Bankruptcy Act, and that accordingly they "constitute a separate class or classes of creditors" within the meaning of the Bankruptcy Act.

THE FACTS.

The proofs of claim by Burns and by the R.F.C. do not claim interest nor interest coupons nor show any dates of presentation of any matured obligations to the treasurer (R. 40), but the proofs of claim of petitioners showed the dates of presentation of the matured obligations owned by petitioners. (R. 38, 75, 78, 72, 64, 80.)

$123,195.00 of the claims of petitioners matured and had been presented to the treasurer for payment and stamped by the treasurer as provided by Section 52 and established in the record. This record, therefore, presents the situation that the only matured claims that were ever presented to the treasurer are those of the petitioners, and if Section 52 gives a preference, it is a preference provided by law, and these claims should have been separately classified.

There is a second point of discrimination involved under this heading as shown by the following facts. Mr. Hubert, secretary of the district, testified that the district quit paying during the month of July, 1933. The Estate of Martin Bekins on November 7, 1933 presented seven matured bonds of $1000.00 each, which were due July 1, 1933, and they were not paid, and the Estate of Katherine Bekins on the same day presented about three coupons of $30.00 each due July 1, 1933, which were not paid. (R. 380.) The secretary of the district further testified that after the district quit paying, it continued to receive assessments from the 1932-33 levy which was made for the

payment of these particular bonds and coupons, and about $17,000.00 had been so received in the bond and interest fund, and at the time of the hearing there was approximately $15,000.00 in the bond principal fund, in addition to about $17,000.00 in the bond interest fund and most of this money was in these funds before these proceedings were filed. (R. 380.) It is contended, therefore, that these bonds and coupons of the two Bekins' estates should in any event be paid in full.

A total of $123,195.00 of bonds and coupons belonging to the petitioners matured from July 1, 1933 to January 1, 1938 (R. 38-60), and have been presented for payment and are secured by the bond funds on hand, and by other surplus funds and by other properties under the provisions of the California Irrigation District Act and must be paid in the order of presentation.

THE LAW.

Section 52 of the California Irrigation District Act provides (see Appendix p. vi):

> "Upon presentation of **any** matured bond of the district, the treasurer shall pay the same from the bond principal fund, and upon presentation of **any** matured interest coupon of any bond of the district, the treasurer **shall** pay the same from the bond interest fund. If money is not available in the fund designated for the payment of any such matured bond or interest coupon, it shall draw interest at the rate of

> seven per cent per annum from the date of its presentation for payment until notice is given that funds are available for its payment, and it shall be stamped and provision made for its payment as in the case of a warrant for the payment of which funds are not available on its presentation." (Emphasis ours.)

Section 61(a) of the California Irrigation District Act makes provision for the payment of warrants for the payment of which funds are not available on presentation, and the pertinent portions thereof are printed in the Appendix. (See p. vii thereof.)

These provisions of the California Irrigation District Act have been construed by a long line of decisions as requiring that matured bonds or matured coupons shall be paid in the order in which they are presented for payment, and, if not paid on presentation, that they shall be stamped or registered, and shall bear interest at seven per cent per annum from date of registration and shall be paid in the order of registration as soon as funds are available.

The leading case on this subject is *Bates v. McHenry,* 123 Cal. App. 81, a case which involves the Merced Irrigation District. At the time of the presentation of interest coupons to the treasurer in that case there was not sufficient money in the bond fund to pay in full all matured coupons. It was contended that payment should be made in order of presentation as long as there is any money in the fund. The Court said:

"The portion of section 52 of the California Irrigation District Laws which we have quoted specifically provides that upon the presentation of any matured bond, or of any matured interest coupon, or any bond of the district, the treasurer shall pay the same from the bond interest fund. There is no provision in the section that payment shall be withheld until all of the matured bonds, or until all of the matured interest coupons have been presented. If there is any money in the fund available for payment, the section makes it the duty of the treasurer to pay the same."

The Court further said:

"Again, the treasurer of the district has authority to perform two acts: He must either pay the bond or interest coupon when presented, or register the same. The irrigation laws do not confer upon the treasurer of the district any authority to prorate payments. If the money is there and the bond or interest coupon is due, his legal duty is to pay. If money is not there, his legal duty is to register the bond and interest coupon and make payment, with the added interest, as soon as sufficient money is available."

The order of the Court was:

"that a writ of mandate issue in this cause, directed to the respondent, to forthwith proceed to make payment in full of any and all interest coupons, in the order in which they were presented for payment, until the entire fund in his hands, available for that purpose, is exhausted, and then to forthwith proceed to register any

and all interest coupons on which payment is not made, if so demanded by the holders thereof."

The next important decision was that of *Shouse v. Quinley,* 3 Cal. (2d) 357, involving the Waterford Irrigation District. In this case the Court held Section 52 (a) of the California Irrigation District Act unconstitutional. This section sought to authorize landowners to pay their taxes with matured bonds and coupons. The Supreme Court of California said in holding the Act unconstitutional:

"By the general terms of the act, the bondholder had the right to have his bonds paid upon presentation if money were available and if not to have them registered and paid in the order of presentation. (*Bates v. McHenry,* 123 Cal. App. 81 (10 Pac. (2d) 1038).)

"It thus becomes apparent that the result of the questioned section is first of all to abrogate the law with respect to the order of payment. So changed, it is as though the law read: Landowners who are the owners or who become such by purchase or otherwise of matured bonds or interest coupons shall be entitled to payment in preference to or without regard to bonds or coupons which have matured and which have been presented and registered previously for payment. * * * The two results mentioned very obviously demonstrate that the nonlandowning bondholder would suffer a very severe change of his contract were it to be held that the section does not impinge upon the constitutional provision against the impairment of the obligation of contracts. It requires no argument to establish that time and

method of payment are material and vital parts of the obligations of a contract.

"* * * The very statement of the argument refutes itself, because the bondholder next in order of presentation is entitled to be paid with the sums realized from the assessment for that purpose and not to be indefinitely postponed. * * *."

The third leading case is that of *Selby v. Oakdale Irrigation District,* 140 Cal. App. 171. The Oakdale Irrigation District was in default at the time and had a refunding plan and subsequently filed a bankruptcy petition. The district made an insufficient levy for its bonds. The suit was a mandamus proceeding to compel the payment of matured bonds and coupons in the order in which they had been presented for payment, notwithstanding that the moneys on hand in the bond funds were insufficient to pay all maturities.

In discussing the question of priority of payment, the Court said:

"Likewise, in the case of Rohwer v. Gibson, 126 Cal. App. 707, 14 P. (2d) 1051, this court held that there being no provision in the law relating to reclamation districts providing for the order in which interest coupons or bonds should be paid, the obligations should be marshaled and the moneys on hand apportioned. Here, again, there is a marked distinction between the reclamation laws and the Irrigation Act. Section 52 of the Irrigation Act, as we held in Bates v. McHenry, supra, provides for the order of payment, and, if not paid, for the registration of both bonds and

interest coupons, and that thereafter, payment shall be made in the order of registration."

The Court then proceeded to discuss the economic question and said:

"Though discussed by counsel, the fact that the bonded indebtedness of the district and the low price of farm products indicate that both bondholders and property owners are suffering, and probably will suffer excessive losses, we do not find that such facts should enter into or determine the rights of the respective bondholders as to what moneys there may be on hand for making payment of the legal obligations of the district."

In the case of *El Camino Irrigation District v. El Camino Land Corporation,* 12 Cal. (2d) 378, 85 Pac. (2d) 123, the Supreme Court of California in holding that the bondholder could not levy execution upon an irrigation district said:

"Moreover, to permit successful judgment creditors, whose bonds may not be prior in registration, to be paid by the proceeds of execution sales, would result in an unjustified preference in favor of those who brought the actions and procured the levies. The lower court in the instant case made an express finding to this effect, and the procedure, unless restricted in some manner unknown to us, would operate to violate the rule of priority established by the decisions in this state. Bates v. McHenry, 123 Cal. App. 81, 10 P. (2d) 1038; Selby v. Oakdale Irrigation District, 140 Cal. App. 171, 35 P. (2d) 125; Strasburger v. Van

Delinder, 17 Cal. App. (2d) 437, 62 P. (2d) 387; Shouse v. Quinley, 3 Cal. (2d) 357, 45 P. (2d) 701."

The District Court of Appeal in California (not the highest Court in the state) in *Clough v. Baber,* 100 Pac. (2d) 519, 101 C. A. D. 306, sought to distinguish these cases as to a district having but $15,000 of assets and bonds of $575,000 in the following language:

> "In none of those cases was the application of sections 52 and 61a of the act involved under circumstances like those of the present proceeding where the district is insolvent and the fund on hand is inadequate to pay more than a small percentage of the matured bonds and obligations of the district, and where all of the lands of the district have been sold and conveyed to the state for delinquent assessments, thereby exhausting all available means of levying future taxes to pay the bondholders. In those cases there was no showing of the injustice of directing the payment of registered bonds so as to deprive all other bondholders of the possibility of ever recovering any substantial portion of their investments therein."

The Court also said:

> "A construction of those cases should not obtain which will absolutely impair or destroy the obligations of the contracts to pay other bonds or coupons by distributing to those who have first registered their bonds all of the funds which the district will ever be able to raise."

However, in the case of *Provident Land Corporation v. Zumwalt,* 12 Cal. (2d) 365, 85 Pac. (2d) 116,

in a case involving a district in much the same circumstances where all the land had been taken by the district itself for non-payment of assessments, the Supreme Court of California, the highest Court in the state, held differently. In this case, the District issued $1,190,000 of bonds. In January, 1936, bonds in the amount of $152,000 and interest coupons in the amount of $225,000 were past due. From 1933 to 1936 the District acquired title to over 10,000 acres of land by tax deed. On January 6, 1936, the Board of Directors passed a resolution to purchase $50,000 of unmatured bonds using $10,000 of "general" fund moneys derived from rentals of tax deeded lands.

The plaintiff was the holder of $86,000 past due bonds and $125,000 of past due coupons which were of course prior in date of presentation and registration to the bonds so purchased and brought suit to set aside the sale and restore the money to the treasury.

The Court pointed out that the ordinary method of payment to bondholders had broken down; that farmers were unable to meet their obligations; that delinquencies mounted, which became increased by the pyramiding system; and that as a result some of these districts now own practically all of the land within their boundaries. The Court said:

> "It is further apparent that the district's method of buying outstanding unmatured bonds at a discount is in effect the giving of a preference to bondholders who are not legally prior in time to others."

The Supreme Court of California further said (pp. 373-374):

> "We do not understand how a debtor owing $360,000, long overdue, can have a surplus of $10,000. Nor do we understand how the district can be entitled to take all of the money derived from the land, whether by sale or lease, and use it for purposes other than payment of the primary obligations of holders of overdue bonds. It is within the discretion of the directors to use some portion of it for running expenses, and where this use is necessary, their discretion will be upheld on familiar principles. But when the directors themselves declare that a surplus exists, over and above the operating needs of the district, two things should be clear: first, that this money should go to the bondholders; and second, that in any event, it should not be given to junior bondholders in preference to those with prior claims, but should be paid on past due bonds and coupons in the order of their presentation." (12 Cal. (2d) 365, 373-374.)

We respectfully submit that the foregoing California decisions clearly establish that Section 52 of the California Irrigation District Act requires that matured bonds and matured coupons of an irrigation district be paid in the order of their presentation for payment, and that any such bond or coupon not so paid be stamped or registered, to be thereafter paid in the order of registration, and inhibits the disbursement of moneys on hand in the District's bond fund on a pro rata or any other basis. These decisions are binding upon this Court under the doctrine of *Erie*

Railroad Co. v. Thompkins, 304 U. S. 64. The Circuit Court of Appeals refused to follow them, thus creating a conflict of decisions, which this Court should correct.

Since this California statute provides that matured bonds and coupons of an irrigation district must be paid in the order of their date of presentation for payment, and confers upon bondholders the substantive correlative **right** to have their bonds so paid, we respectfully submit that the moneys on hand in the bond fund of the District are in effect "pledged" for the payment of the matured bonds and coupons of petitioners within the meaning of Section 83(b) of the Bankruptcy Act.

Likewise the surplus moneys over and above necessary operating expenses, such as the $100,000 deposited with the R.F.C. as security (R. 383) against the possibility of the petitioners being ultimately successful, and all other surplus funds (R. 347) and tax process property constitute trust funds securing the preference claimed. In *Provident Land Corporation v. Zumwalt,* 12 Cal. (2d) 365, 85 Pac. (2d) 116, the Court said:

> "In our opinion, the statute was intended to secure the bonds by the proceeds of the land in the district."

The Court also said:

> "but the lands remain in trust, and the district exercises its powers, however broad, as a trustee. Once it is made clear that the lands are held in trust, it necessarily follows that their proceeds, whether by sale or lease, are likewise subject to the trust."

It is well settled that words used in a statute, including acts of Congress, are to be given their ordinary and common meaning, unless there is something in the statute itself clearly indicating otherwise.

Columbia Water Power Co. v. Columbia Electric Street R. L. & P. Co., 172 U. S. 475, 43 L. ed. 521;

Blair v. Chicago, 201 U. S. 400, 51 L. ed. 801;

Caminetti v. United States, 242 U. S. 470, 61 L. ed. 442;

De Ganay v. Lederer, 250 U. S. 376, 63 L. ed. 1042;

Woolford Realty Co. v. Rose, 286 U. S. 319, 76 L. ed. 1128;

Avery v. Commissioner of Internal Revenue, 292 U. S. 210, 78 L. ed. 1216;

Old Colony T. Co. v. Commissioner of Internal Revenue, 301 U. S. 379, 81 L. ed. 1169;

United States v. Wurts, 303 U. S. 414, 82 L. ed. 932.

The term "pledged", given its ordinary and common meaning, signifies a solemn promise made which is not to be violated. In *Brook v. City of Philadelphia*, 162 Penn. 123, 29 Atl. 387, 390, this was held to be the meaning of the word in a constitutional provision directing that every city shall create a sinking fund which shall be inviolably pledged for the payment of the public debt. We therefore respectfully submit that the term "pledged" as used in Section 83 (b) of the Bankruptcy Act, was used in the same sense, and includes the claims of petitioner by reason of the fact

that Section 52 of the California Irrigation District Act in effect "pledged" the use of the moneys on hand in the bond fund of the District to the payment of matured bonds and coupons in the order of their date of presentation.

This Court in *City of Lincoln v. Luning,* 133 U. S. 529, 33 L. ed. 767, referring to a similar statute providing for the registry of overdue coupons and imposing upon the county treasurer the duty of thereafter paying the coupons as money came into his possession applicable thereto in their order of registration (Stats. of Nev. 1877, et), said:

> "This Act, providing for registration and for payment in a particular order, was a new provision for the payment of these bonds, which was accepted by the creditor, and created a new right upon which he might rely. It provided, as it were, a special trust fund, to which the coupon holder might, in the order of registration, look for payment, and for payment through which he might safely wait. It amounted to a promise on the part of the county to pay such coupons as were registered, in the order of their registration, as fast as money came into the interest fund; and such promise was by the creditor accepted;".

This construction of the statute is made doubly certain by the words "without preference" appearing in Section 83 (b).

This Court should not hold that the word "pledged" is used in a technical sense and as referring to a bailment to be maintained by delivery and possession of

specific property or revenues for the additional reason that the statute is dealing with municipal and other public corporations, very few of which are ever authorized to deliver specific property or funds as security for the payment of its obligations.

But even if it should be so held, certainly the claims of petitioners "are otherwise given preference as provided by law" within the meaning of Section 83 (b), and hence according to the express provision thereof "shall accordingly constitute a separate class or classes of creditors".

Any claim that the preferences and priorities which petitioners have under the state law are to be ignored, is answered by the following extract from *In re Consolidated Iron & Steel Mfg. Co.* (C. C. A. 6), 76 Fed. (2d) 837:

> "This does not signify that the law of Ohio can or does of its own force determine priorities under the National Bankruptcy Act. It means that the National Bankruptcy Act prescribes that effect shall be given to state laws which do give priority to certain debts. *In re Bennett,* 153 F. 673 (C. C. A. 6)."
>
> *Ginsberg v. Lindel,* 107 Fed. (2d) 721, 725, 726.

The contracts and claims of creditors of the District arose and are governed by state laws, and the reference in Section 83 (b) to claims "which are otherwise given preference as provided by law" obviously refers to the law of the state, for the same reason that this Court held in *United States v. Bekins,* 304 U. S. 27, that the provision in subdivision (e) of Section 83 of

the Bankruptcy Act, to the effect that it must appear that petitioner "is authorized by law to take all action necessary to be taken by it to carry out the plan",

"manifestly refers to the law of the state".

The petitioners were the only creditors having matured claims presented to and registered by the Treasurer. This situation did not exist in the Merced case where the lower Court discussed the point.

The obvious purpose of the statute in requiring that creditors be classified "according to the nature of their respective claims and interests" is that those who are entitled to be in a separate class be separately treated in the plan of composition in order to conform to the requirement of the statute (Sec. 83(e)) that the plan be "fair, equitable, and for the best interests of the creditors", and that it "does not discriminate unfairly in favor of any creditor or class of creditors;". Further, how are creditors who are in the position of petitioners to protect the preferences and priority which they have under the above California decisions construing Section 52 of the California Irrigation District Act, if they are not separately classified? They at least were entitled to be placed in one general class, separate and apart from other creditors not having similar preferences and priorities, so that it could be determined whether they as a class assented by the required majority to the plan of composition. Putting them into the same class with other creditors, merely put them at the mercy of the holders of a larger amount of bonds, with everything to gain and nothing

to lose by ignoring and disregarding the preferences and priorities of petitioners.

This branch of the case presents several important questions of wide public interest as to the proper construction of the provisions of Section 83 (b) of the Bankruptcy Act relating to the classification of creditors which should be determined by this Court; it also presents a case where the Circuit Court of Appeals has refused to follow the decisions of the highest Court of the state on a question of state law. This makes an additional reason why certiorari should be granted.

CONCLUSION.

It is submitted that the writ of certiorari should be granted, the decree of the Court below reversed and the proceeding directed to be dismissed.

Dated, Turlock, California,
January 6, 1941.

Respectfully submitted,
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(Appendix Follows.)